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September 20, 1993

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

William Caton
Acting Secretary
Federal Comm;unications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 93-162

Dear Mr. Caton:

Transmitted herewith, on behalf of Teleport Denver Ltd., are an original and seven copies of its Comments on Direct Case.

Any questions and copies of all correspondence regarding this matter should be directed to undersigned counsel.

Very truly yours,

Joseph P. Benkert

JPB/pdl

Enclosures

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, DC 20554

In the Matter of	)	
	)	
Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection for Special Access	)	CC Docket No. 93-162
	)	
US West Communications, Inc. Revisions to Tariff FCC No. 1	)	Transmittal Nos. 331, 338, 362, 368 and 383

COMMENTS ON DIRECT CASE

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September 20, 1993

SUMMARY OF ARGUMENT

U.S. West Communications, Inc. ("USWC") has adopted an expanded interconnection and collocation ("EIC") tariff which is unreasonble and burdens competitors and competition. USWC's EIC tariff requires that special access competitors, in order to obtain "equal" access to essential facilities, pay rates that include layered recovery of overhead and profits to USWC. The tariffed rates of collocation and interconnection for special access competitors should be no greater than the charges USWC imputes to itself in setting its own rates for its competing services.

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COMMENTS ON DIRECT CASE

Teleport Denver Ltd. ("TDL"), by its attorneys, hereby submits its Comments on the US West Communications, Inc. Direct Case filed by US West Communications, Inc. ("USWC") in this proceeding on August 20, 1993 ("USWC Direct Case") filed in response to the Commission's July 3, 1993 Investigation Order in this Docket (the "Investigation Order"). In support whereof, the following is respectfully shown.

I. Introduction and Preliminary Matters

TDL notes, as a preliminary matter, that USWC apparently takes exception to the Commission's request that USWC provide certain information which USWC believes it has already sufficiently provided, and USWC also appears to incorporate by reference its earlier arguments and information with respect to such matters. Rather than seizing upon this trivial point to criticize the Common Carrier Bureau ("Bureau"), USWC should recognize that (i) while specific references were made to USWC's tariff for purposes of illustration, the Bureau's order requires the requested information of all LECs whose tariffs contain a similar provision or structure, and (ii) the Bureau also had the purpose of obtaining all relevant information in a format and context most conducive to the conduct of its analysis. Similarly, the format and context in which the Bureau has requested that the information be provided is such that USWC should itself be able to identify flaws in its costing and pricing methodology, and better propose reasonable rates.

The fact that USWC does criticize the Bureau for requesting that the information be provided in a format and context conducive to evaluation and resolution of the issues in this proceeding support the conclusion that USWC has effectively delayed the availability and complete implementation of interconnection and collocation through filing an unreasonable tariff requiring investigation. It is because of such preference of some parties, preference for contention before the Commission to competition in the marketplace that the Commission should either exercise or seek, as appropriate, authority to (i) award parties to Commission proceedings their costs and fees, including legal fees, in opposing, or participating in proceedings required by unfounded, specious, strike or other improper applications and pleadings not asserted in good faith, and (ii) assess applicants that file such applications or pleadings the Commission's personnel and other costs in reviewing and disposing of such applications or pleadings. It is undisputed that a disproportionately significant amount of the Commission's budget and processes is occupied by such bad faith filings. These include pleadings filed by parties using the inevitable delay attendant to the regulatory processes to protect their markets. Thus, the Commission should require that these parties bear the costs of their own vexatious conduct as a matter of fairness and as a deterrent to future improper filings (but not to legitimate filings). While USWC has reduced its tariff rates at the request of the Commission and those rates have gone into effect during the pendency of this investigation, it cannot be gainsaid that USWC's tactics have created uncertainty as to its eventual rates and has deterred the full implementation of interconnection and collocation.

USWC also assails the Bureau's approach to expanded interconnection and reallocation ("EIC") as "logically flawed and internally inconsistent," and claims that the Bureau wants to "have it both ways." USWC Direct Case, at 2. It is USWC which is duplicitous, however, and in the very context in which it attacks the Bureau. Thus, for example, USWC wants to charge fair market rates for space rental, which typically include recovery of quotation preparation, improvements (build out), and even include discounted or deferred rental provisions; yet USWC also wants to assess non-recurring charges for quotation fees, improvements, etc. In any event, USWC's arguments based on "market rents" or "commercial rents" may be suspect, given the fact that USWC's parent, has been the which a shareholder derivative suit related to its real estate dealings and USWC has been, and is the subject of utility commission investigations regarding USWC's execution of long-term leases at rates several times the prevailing market rates in certain of the markets in which it operates. Moreover, USWC regards the fact that the Bureau's comments USWC's EIC tariff addressed structural issues, not rate levels.

Finally, in criticizing the Bureau's requirement that unbundled rate elements be offered when commercial rents are not unbundled, USWC misapprehends the Order Designating Issues for Investigation in this Docket. The Bureau <u>clearly</u> did not require unbundled rates, but rather required that to facilitate effective Bureau review, the LECs demonstrate through provision of unbundled cost and rate elements that they are not over-recovering for EIC and thereby violating the Act and pursuing anti-competitive ends. While "commercial rents" are not subjected to such investigation, commercial lessors do not control their competitor's access to essential bottleneck facilities. If a commercial lessor operating in a competitive market where to impose such restrictions and layer its overhead in setting "rens" as USWC has done, potential lessees would not rent from someone else. Competitive Access providers do not have the opportunity to "rent" from someone else and compete on a level playing field. In any event, this proceeding was necessitated by the LECs' own improper tariffs, not Bureau caprice.

II. <u>USWC's Tariffed Rates Are Excessive, and Its Regulations Unreasonable</u>[1]

A. <u>The Rate Levels Established in USWC's Physical and Virtual Expanded Interconnection Tariff Are Excessive (§IIA)</u>

A review of the information provided in the direct cases of the LECs, including USWC, establishes that USWC's EIC rates are too high. The most fundamental problem with USWC's EIC rates is that they are designed to earn a return -- a profit for USWC -- and thus burden competition.

The Commission has not required that USWC or any other LEC enter the "real estate rental business," but rather that Tier I LECs permit competing access providers equivalent access to the bottleneck facilities which the LECs have established and control by virtue of their longstanding public charters, protected monopolies and guaranteed rates of return. Given that the purpose of the special access collocation and interconnection requirement is to encourage competition (and contemporaneously provide regulatory relief for LECs providing dedicated access) the LEC should not be permitted to frustrate this purpose by further burdening emerging special access competition with costs the LEC

[1]TDL here responds to USWC's Direct Case responses to the specific issues designated by the Commission. The section of the Investigation Order in which the issues were raised is indicated in parenthesis at the end of each TDL subheading, where TDL omits to respond to USWC's arguments regarding a designated issue, that omission should not be taken to indicate that TDL regards USWC's position on tariff requirements to be reasonable.

does not bear.[2] For LECs to both impose unique costs on interconnectors <u>and</u> receive monopoly rents for collocation is particularly devastating to competition and the public interest. The excessive rents assure that interconnector/competitive access providers' rates for service will be maintained at non-competitive rates above those of the LEC, while the LEC can use its monopoly profits from EIC to subsidize its own competitive service rates and maintain them below cost.

1. <u>USWC's Tariff Review Plan Demonstrates That Its EIC Rates are Unreasonable</u>

USWC provides its Tariff Review Plan at Appendix A to its Direct Case. That Tariff Review Plan demonstrates that both USWC's recurring and non-recurring EIC rate elements are designed to double-recover overhead loadings and recover monopoly profits.

a. <u>Recurring Rate Elements</u>

Taking as an example USWC's first schedule in the TRP, line 1 provides the total investment in the equipment related to that rate element. USWC explains at page 7 of its Direct Case that this "total installed investment represents the cost of the <u>material</u>, <u>labor</u> and <u>engineering</u> to install the investment and <u>miscellaneous loadings</u>. These costs are recovered through the depreciation expense ("booked depreciation) as set forth at line 21 of the TRP schedule, as described at page 8 of USWC's Direct Case. The depreciation expense is determined by dividing the amount of the

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[2] USWC's Direct Case demonstrates that its EIC rates openly include as much as an 83% profit margin, and additional profit margins are layered into USWC's rates.

total installed investment as represented on line 1 of the Schedule, less salvage value, by the depreciable life of the plant and equipment as set forth at line 2, and including a factor for the time value of money. (Although USWC does not reflect the inclusion of a factor for the time value of money in the depreciation expense (see USWC Direct Case, p. 8), such a factor must be included to produce the result obtained from the above described operation.)

After including loadings in the total installed investment, USWC then adds additional loadings at lines 21-50, but with the loadings at line 1 unspecified, it cannot be determined that there is no duplication in the annual charge factors provided at lines 21-50. More significantly, the itemized overhead loadings appear to represent a spreading of general overhead for the central office to include the services to the interconnecter as well as other services provided by USWC. Thus, factors are provided for parts, management, sales, number services, external relations, general office expenses, uncollectibles, computers, business fees and billing and collections in amounts which do not appear to bear a logical relation to the interconnector service alone, and where there is no additional cost causation by the interconnector. Any spreading of general overhead expenses thus reduces incrementally USWC's cost of providing a competing service and requires the interconnector to, in fact, subsidize USWC's competitive services. Notably, USWC would not even be required to spread general overhead loadings to its own private line services under the competitive necessity doctrine, but rather need only base its rates on incremental costs plus "some" contribution to overhead. Similarly, the goals of special access, allocation and interconnection are best achieved through basing EIC rates upon incremental costs.

TDL also notes that USWC does not appear to give any effect to tax depreciation, and at page 9 excludes consideration of the impact of tax depreciation on income, in calculating the costs on its recurring rate schedules. Simultaneously, USWC states that its cost of money included at line 22 is intended to repay capitalized amounts and provide a return to the investor. USWC Direct Case at p. 9. USWC also includes factors to recover income tax on the return it realizes.

Finally, after summing its depreciation expense (recovering the capitalized expense of the total investment, including cost of materials, labor, engineering and loadings; a return on investment, and other loadings), USWC calculates the annual cost per unit and the monthly cost per unit. On the first schedule to USWC's Exhibit A, these amounts are $59.41 and $4.95, respectively. USWC charges a monthly rate per unit of $7.13, however, providing a rate to unit cost ratio of 1.44 (or a profit margin of 44%) and a rate to direct cost ratio of 1.59 (a profit margin on direct costs of 59%).[3] Thus, USWC is layering overhead and returns to earn a significant profit on EIC.

[3] The profit margin is equal to the rate to cost ratio, minus 1.0.

USWC also explains at page 9 of its Direct Case that USWC's return on the capital expenditure is front-loaded, with the monthly depreciation expense representing return on investment decreasing over time. The net result is that the same time USWC's competitors' cost of doing business are being increased by a factor to represent return in profits to USWC, USWC is realizing a disproportionate return to further subsidize its cost of providing the same services to customers.

b. <u>Non-Recurring Rate Elements</u>

USWC has chosen to recover real estate and common construction costs through non-recurring rate elements. An analysis of USWC's TRP schedules for non-recurring costs, and USWC's explanation of its calculation of non-recurring rate elements, demonstrate additional over-recovery. Thus, USWC has added 20% to the cost of common construction costs as a contingency in the event that USWC runs into unknown barriers and obstacles requiring additional labor or materials. USWC Direct Case, at 11. Such a contingency is an aberration in a rate schedule which specifically calculates costs and rates. More significantly, it would be more appropriate for USWC to surcharge interconnectors a fee representing the actual cost for any such unique contingencies than to charge all connectors a blanket 20% contingency fee. This would be particularly appropriate inasmuch as USWC's central offices were specifically designed for the type of construction and use to which they would be put by interconnectors; so that "unknown barriers and obstacles" are unlikely.

USWC also adds 20% to the construction cost, after adding the 20% construction contingency fee, for what it describes as an American with Disabilities Act ("ADA") construction provision. It is unclear what the purpose of this ADA construction provision is for, and absent a detailed explanation or justification, it should not be allowed. Finally, <u>after</u> adding 44% to the common construction costs for the contingency fee and ADA construction provision, USWC adds 15% of the increased construction costs (actual construction costs plus contingency fee plus ADA construction provision) for professional engineering consulting services. Thus, each interconnector will be charged a fee equal to 15% of the already inflated construction costs for professional engineering consulting services, whether or not USWC incurs fees for professional engineering consulting services. It also would appear that any such fees are incorporated in USWC's construction costs, as well as in its quotation fee rate element. It is also curious that USWC would charge professional engineering consulting services as a percent of all construction costs even when USWC's central offices and have been designed and constructed for the purpose for which the interconnector proposes to use them; the interconnectors' equipment will often replace older vintage switching and routing equipment, as the Cal. location space is in many cases available because of the reduced size (and power requirements) of more modern switching and routing equipment, and USWC may well employ its own professional engineers given the scope of its business, rather than hiring outside consultants for such routine installations in USWC switching and routing centers. If USWC does employ professional engineers, then the overhead attributed to them would already be included in USWC's overhead and rate elements, and USWC would enjoy a cost savings over the use of professional engineering consultants who also make allowance in their rates for overhead. In sum, USWC's construction contingency, ADA construction provision and professional engineering consulting service allowance provides USWC a 45% margin on construction costs.

After allowing for professional engineering consulting services, USWC also includes a rate element for a construction management project engineer. Those rates also include overhead loadings for benefits categorized as "other" and property-related overhead costs, even though there does not appear to be any cost causation by the interconnector. That is, the decision by a competitor to collocate and interconnect in a USWC office does not cause USWC to hire an additional construction management project engineer and expand USWC's overhead. Such additional layering of the USWC overhead, again, artificially inflates USWC's competitors' costs of providing services with access to essential facilities while lowering USWC's cost of providing those same services with access to the essential facilities. Finally, USWC includes depreciation expense allowing for additional return, omits to consider post-tax profits, and loads additional (and, perhaps, duplicative) overhead costs into its non-recurring rates. Using USWC's first non-recurring rate schedule in its TRP, the DS-1 cross-connection provisioning function, USWC loads in these costs and derives a monthly and an annual cost per unit of $266.31. This cost is, in fact, the same cost, since it is a non-recurring charge. After arriving at this cost figure, USWC then applies an 83% profit margin and enjoys over a six thousand percent recovery against the direct costs involved.

c. Additional Issues Regarding the Reasonableness of <u>USWC's Rate Structures</u>

Additional questions exist regarding USWC's cost and rate structures. For example, USWC's rate elements for construction include provisions for power HVAC/receptacles, lights and fire detection in a hard wall enclosure which are less than the construction costs for provision of HVAC, electrical receptacles and lighting fixtures (but not fire detection) for cage-type enclosures. Compare USWC Direct Case, pp. 15 and 16. TDL again observes that the buildings in which the interconnectors are collocating have already been constructed for the purpose of housing switching and routing equipment, have presumably been outfitted with air conditioning, humidification, and redundant systems designed for each building's capacity. Technological advances have reduced the space and related requirements for the USWC's switching and routing equipment, which is the reason collocation space is available. Thus, in most cases, collocation by an interconnector will not force USWC to incur any additional construction expense related to climate control systems.

The location of additional equipment in interconnectors' collocated space will add heat load beyond that resulting from USWC's operation of its equipment, and it is therefore not unfair or improper for USWC to include a rate element for the additional electric power required for the additional climate control. It is unclear from USWC's description of these rate elements (USWC Direct Case, pp. 18-20) and USWC's TRP schedules whether these rates are based upon the power actually used by the interconnector, or simply on the basis of the power capacity provided to each interconnector. If based upon the power capacity provided to the interconnector, the power capacity provided is related to the interconnector space, even though the space required by an interconnector may include provision for anticipated expansion, and non-operating, redundant stand-by equipment. Thus, the power provided interconnectors may not bear any relation to the contribution to heat load by the collocator.

After establishing recurring and non-recurring rates for construction and services which include margins for return on investment and profits, USWC establishes a rate element for floor space representing market value base rents. From a cost causation standpoint, the base rents per square foot of floor space occupied solely represent profit. Except in cases of leased central office space, the space is already available to USWC and will be carried by USWC whether or not it is occupied by an interconnector. Thus, no additional cost is incurred by USWC in making this space available (other than costs already provided for), and no additional property tax is incurred as a result of the interconnectors' collocation. Moreover, the "market value", as determined by USWC, bears no relation to the actual rental value of USWC's space, which was constructed, designed and configured to house equipment, and for periodic visits by personnel. In most cases where extra space is available for use by collocators, the central offices were constructed in an age of earlier, vintage equipment, which required design of floors to maintain greater loads. This space is more comparable to a warehouse space, than to office space or executive office suites where appearance, comfort and the provision of services are primary considerations. Similarly, the estimate of cost for converting office space to mainframe computer space is not a fair comparison inasmuch as, generally, central offices were initially designed and constructed for the use to which they are being put, the installation of interconnector equipment does not deprive USWC of leasable office space at market rates, and the design, decoration and condition of common areas do not impact the "market value" of the central office space as they do with typical office space. Moreover, unlike executive office suites, common services such as telephone reception, a receptionist, conference rooms, copying and word processing services and other services will not be provided interconnectors.

USWC states at page 26 of its Direct Case that it adds to the market rate for the collocator space rate elements for maintenance expense. These maintenance expenses, which are not insignificant, are inappropriate in the context of an addition to market rates. TDL is not satisfied that the market rates USWC applies do not include property tax or maintenance cost, and again notes the distinction between market rates for office space and the central "office" space leased to collocators, even if the market values applied by USWC would not include maintenance expenses. There is a vast difference between the type of maintenance required with respect to commercial office space which might not be included in rents, and the maintenance expense for central office space which USWC would incur whether or not the interconnector collocated there.

d. <u>USWC's EIC "Preparation Fee" Is Unreasonable</u>

USWC has also included in its tariff a physical/virtual EIC "preparation fee" for USWC to respond to an interconnector's request as to the cost of collocation. This fee appears to duplicate the other engineering costs included in USWC's rate elements, adds percentages to construction costs for professional consulting fees and overhead loadings, and duplicates functions of the interconnector in engineering review of its own network facilities and interconnections. The elements of this "preparation fee" are set forth at Exhibit "D" to USWC's Direct Case. These "preparation fees" also include project management functions which appear to duplicate costs included in the rate elements for the actual construction. Moreover, these charges include overhead loadings, even where there is no cost causation, and appear to provide a 72% return to USWC. Although USWC refers to a 1.72 overhead ratio applied consistently across all rate elements, except for several elements to which a 1.3 overhead factor was applied, itemized elements of overhead are included in the charges before application of that overhead loading factor, suggesting double recovery and profiteering.

e. Comparison of EIC and DS-1, DS-3 Overhead Loadings (II A.1.c.(1)-d)

USWC takes issue with the value of comparing the costs USWC imputes to itself in establishing its rates for DS-1 and DS-3 services, and the rates established for interconnection and collocation. In arguing that the costs and rates for services are not comparable, however, USWC appears to rely on advantages from ratcheting (finding economies in the complete circuit as opposed to the bottleneck switch facilities). USWC also recognized that in providing additional services, it merely adds equipment to empty floor space. It will be recalled that USWC calculates market rents to include the cost of modifying commercial office space for use as a central office (computer room), which could alternatively be used as commercial office space and garners higher rents. It is not the comparision of EIC rates with DS-1 and DS-3 rates which is unreasonable, however, but USWC's comparison of central office space with commercial office space.

2. Individual Rate Elements

a. Embedded Costs vs. Current or Prospective Costs for Floor Space Charges (II.A.2.(b)(1))

USWC states that it establishes its floor space rates on market values, and not on book value or embedded cost. TDL has demonstrated that the market rates USWC uses are not for comparable space or purposes. USWC's floor space rates should be based upon embedded cost, so that it is not charging its competitors any greater amount for collocated interconnection than USWC imputes to itself in establishing its own rates. TDL has shown that permitting USWC to impose a profit margin into the cost structure of competing special access providers provides USWC a substantial competitive advantage and has anti-competitive impacts.

b. Use of Repeaters (II.A.2.(d)(1))

USWC states that repeaters will be necessary for most interconnectors because of the distances between the interconnectors' physical space in the central office (or outside the central office in the case of virtual collocation) and USWC's shared network DSX panels. Collocation and interconnection is intended to level the playing field between LECs and competing special access providers. The playing field will not be leveled if LECs are able to impose on competitor's costs which it does not incur or impute to itself. Thus, where USWC does not use repeaters or repeaters are required only because of the space collocated to the interconnector by USWC, the cost related to that repeater should not be assessed to the interconnector, but should be treated as overhead, and that overhead should be spread among interconnectors and USWC alike.

c. Inclusion of POT Frame or POT Bay in Interconnection Rate Elements (II.A.2(d)(3))

USWC states that it does provision a DSX in the interconnectors' leased space as part of its EIC offering, and include rate elements for this in its tariff. This DSX constitutes the demarcation point between the interconnectors' facilities and USWC's facilities, with USWC providing the connection to the main distribution frame ("MDF"). This proposal defeats one purpose and advantage of interconnection, the interconnectors' ability to control and maintain its lines to the point of interconnection. While USWC claims that its DSX is necessary because it establishes a clear demarcation point for the isolation of trouble, establishes responsibility for repair, allows USWC to hand off a templated DS-1 DS-3 signal, and provides the interconnector flexibility to connect any channel of its DSX to any channel of USWC's DSX, the additional DSX is not, in fact, necessary for these purposes. The interconnector, in competition with USWC, should be able to interconnect with the MDF. Even if modern diagnostic procedures do not permit adequate isolation of troubled responsibility for repair between the MDF and the interconnectors' facilities, determination of whether trouble is occurring within the MDF or the cable should be sufficiently ascertainable and the potential for dispute over responsibility for repair would appear to be less where USWC does not continue to provide critical interconnections between the MDF and the interconnectors' facilities. While the DSX interface arrangement established by USWC may permit USWC to "hand off a templated DS-1/DS-3 signal", the concept of expanded interconnection and/or level playing field does not encompass such a service by USWC. Finally, TDL fails to understand USWC's claim that this interface is necessary for the interconnector to connect any channel of its DSX to any channel on USWC's DSX.

d. <u>Security (II.S.2.(e))</u>

USWC claims that it is necessary to have any interconnector employee escorted during the entire time that he/she is on USWC property, that interconnectors will not be permitted to have any employees who are former employees of USWC or who are not U.S. citizens enter USWC property, even if escorted, because of the World Trade Center bombing. Interconnectors may well wish to make arrangements to avoid being charged by USWC for responsibility for any equipment failure or other problem incurred by USWC which coincides with the time period that any interconnector employee was on USWC property. This, however, should be the decision of the interconnector, taking into consideration the amount of time the interconnector anticipates having its personnel on USWC property, and the perceived likelihood of an equipment failure or other problem occurring with USWC assets accessible to interconnector employees.

To be clear, TDL does not object to reasonable security precautions, including background checks of its own employees, and other reasonable measures. USWC's security provisions, however, are intended solely to harass, impede, and increase the expense to its collocating competitors. The restrictions USWC seeks to impose bear no relation to its security concerns and USWC's own implementation of those provisions undermines the very need for them. For example, USWC would exclude any former employee of USWC from entering USWC's property, when USWC's employment of that individual would indicate that USWC did not find the individual a security risk. Insofar as USWC may argue that there is a risk of a former USWC employee seeking retribution for wrongs done by USWC, TDL notes that this restriction is not limited to employees who were fired by USWC, and there is no evidence even that individuals dismissed or otherwise terminated by USWC who found subsequent employment with a competitor would sabotage USWC operations while in a USWC central office on behalf of the new employer. Nor is TDL aware of any USWC policy against employing aliens or restricting access of alien employees to its central offices because they are aliens.

Finally, USWC's true purposes are disclosed by the fact that USWC states that it will contract with an outside security contractor to escort interconnector employees while on LEC property. The fact that USWC would rely on non-USWC employees to escort interconnector employees on USWC property puts the lie to USWC's concern with employees other than its own entering the central offices. With specific reference to USWC's footnote 66 in its Direct Case, TDL states that USWC should not impose any greater security requirements upon interconnectors than it imposes with respect to its own employees (e.g., if USWC does not exclude alien employees from its central offices, it should not exclude alien employees of interconnectors from its central offices) and it should not be permitted to impose a blanket exclusion on former